UNITED STATES
TELEPHONE
ASSOCIATION

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August 20, 1996

William Caton
Secretary
Federal Communications Commission
1919 M Street, NW
Room 222
Washington, D.C. 20554

DOCKET FILE COPY ORIGINAL

Dear Mr. Caton:

RE: Erratum Filing, CS Docket No. 96-133 USTA Reply Comments

Attached are an original and 4 copies of USTA's Erratum filing in the above-referenced proceeding. USTA inadvertently omitted the certificate of service in the filing made on August 19 to the Commission. Parties were unaffected. Please include a copy of this filing in the record.

Sincerely,

Keith Townsend

Keith Townsend
Director
Regulatory Affairs & Counsel.

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AUG 20 1996

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
	)	
Annual Assessment of the Status	)	CS Docket No. 96-133
of Competition in the Market for	)	
the Delivery of Video Programming	)	

REPLY COMMENTS OF
UNITED STATES TELEPHONE ASSOCIATION

UNITED STATES TELEPHONE ASSOCIATION

By Its Counsel:

Mary McDermott
Linda Kent
Charles D. Cosson
Keith Townsend

1401 H Street, NW
Suite 600
Washington, D.C. 20005
(202) 326-7247

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SUMMARY

In the 1995 assessment of competition in the video programming market, the Commission concluded that incumbent cable providers maintain market power. USTA agrees. Passage of the Telecommunications Act of 1996 ("Act") signals Congressional intent to change the *status quo*. With streamlined regulation, multiple entry options for video program distribution, and the elimination of video dialtone regulations and the cable/telco cross ownership ban, Congress has expressed its intent that LECs should become competitive alternatives to incumbent cable providers for consumers.

Good intentions, however, have paved many roads. The video programming market may never evolve into the type of competitive environment that will guarantee that LECs can provide the robust competition envisioned by Congress. Impediments to LECs becoming competitive providers of video programming include (1) overreaching regulatory interpretations of the Act, (2) inconsistent application of regulations, (3) the absence of LEC access to the same programming on terms and conditions equal to those received by cable operators and (4) cost allocation and exogenous price-cap proposals that serve as disincentives for LECs to deploy broadband networks.

USTA members await with eager anticipation the opportunity to exploit various entry options to provide video programming. Under the appropriate pro-competitive, de-regulatory environment, LECs will play a significant role in video program distribution. Consumers will benefit from multiple providers of video programming though expanded choices, lower prices and improved service.

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REPLY COMMENTS OF
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I. INTRODUCTION

The United States Telephone Association ("USTA") respectfully submits these reply comments in response to the Commission's *Notice of Inquiry*.[1] USTA is the major trade association of the local exchange carrier ("LEC") industry with over 1, 000 members. Our membership is considering options on providing video programming.

Contrary to the optimistic tone of some comments, competition in the video services marketplace is a phrase in search of substance. The landscape is littered with promises, pious projections, premature predictions, and pontificates preaching the virtues of competition. USTA finds little to cheer about for consumers as they face rising costs for video programming, and the potential loss of LECs as facilities-based competitors. Simply put, the video services market is neither competitive, nor have substantial changes in the marketplace occurred since the

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1 CS Docket No. 96-133, FCC 96-265, released June 13, 1996.

Commission's last report to warrant enthusiastic praise for the present state-of-affairs.

The passage of the Telecommunications Act of 1996 ("Act")[2], however, creates opportunity for open competition in the video programming market, if implementation is accomplished in accordance with the Act. USTA members welcome the challenge of competing on a level playing field with incumbent cable providers. A number of potholes on the road to full competition, however, remain as impediments to the kind of competition envisioned by the 1996 Act. Issues such as the negative impact of vertical mergers, lack of parity of programming, and proposed cost-allocation regulations that, on their face, serve as a disincentive to LECs expending the financial resources necessary to become effective competitors to cable providers. These issues must be resolved before consumers realize the full benefits of uninhibited competition in video programming.

II. PASSAGE OF THE TELECOMMUNICATIONS ACT PROVIDES OPPORTUNITIES NOT GUARANTEES FOR COMPETITION IN THE VIDEO PROGRAMMING MARKET

With passage of the 1996 Act, Congress intended that there be vigorous competition in all telecommunications markets. As Congress stated, the Act was intended "...to provide for a pro-competitive, de-regulatory national policy framework designed to accelerate rapidly private sector deployment of advanced telecommunications and information technologies and services to all Americans by opening all telecommunications markets to competition."[3]

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[2] P.L. 104-104, 110 Stat. 56, February 8, 1996.

[3] *See Telecommunications Act of 1996,* Senate Report 104-230, *Joint Explanatory Statement* at 113.

Congress clearly intended that LECs would become active participants in the video services market by removing barriers to entry. The 1996 Act repealed the cable/telco cross-ownership regulations which prohibited LECs from providing video services to subscribers in the LECs' service area.[4] Congress also repealed the onerous video dialtone regulations which had stifled LECs from providing video programming directly to customers through their telephone wires.[5] The death of video dialtone regulation is welcomed. As Congress concluded "Those rules implemented a rigid common carrier regime, including the Commission's customer premise equipment and *Computer III* rules, and thereby created substantial obstacles to the actual operation of open video systems."[6]

In lieu of "substantial obstacles" to competitive entry, Congress specified in the Act four (4) options that LECs could pursue to enter the video programming market. These options include (1) radio-based systems under Title III; (2) common carrier video traffic under Title II; (3) cable-based programming under Title VI; and (4) video programming provided through open video systems ("OVS").[7] Congress determined that the basis for establishing these four enumerated options for LECs to provide video programming is that one size does not fit all: "Recognizing that there can be different strategies, services and technologies for entering video

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4 *See* Section 302(b)(1) of the Telecommunications Act repealed 47 U.S.C. §533(b). Under the rural exception to the repealed cable/telco cross-ownership ban, more than 300 small LECs provide video programming to their subscribers.

5 *See* Section 302(b)(3) repealing the requirements established in the Commission's CC Docket No. 87-266.

6 *See Telecommunications Act,* Senate Report 104-230, *Conference Agreement* at 179.

7 *See Telecommunications Act of 1996*, §651(a)(1-4), 47 U.S.C. 571(a)(1-4).

markets, the conferees agree to multiple entry options to promote competition, to encourage investment in new technologies and to maximize consumer choice of services that best meet their information and entertainment needs."[8] Elimination of entry barriers to free market enterprise is only the beginning. Streamlined regulation and reform is required before competition will flourish. Critically important to any LEC successfully competing against incumbent cable providers is access to the same programming on equal terms and conditions as cable system owners receive from affiliated programmers. With respect to cable reform, USTA supports deregulation of the cable industry with reliance on the marketplace and competition to the "maximum extent possible."[9] LEC access to programming on terms and conditions equal to cable owners and programmers is one of the most important issues to competition developing in video programming.[10]

Equally critical to LECs competing on a par with cable companies is the elimination of both old and new barriers to market entry in Commission Orders implementing the 1996 Act. As USTA has made clear in the OVS proceedings, Congress intended that OVS provide a competitive alternative to cable programming, and regulations to implement the intent of Congress should be minimal to maximize the earliest deployment of OVS.[11] For example,

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[8] *See Telecommunications Act of 1996,* Senate Conference Report 104-230, *Conference Agreement* at 172.

[9] *See Implementation of Cable Act Reform Provisions of the Telecommunications Act of 1996,* CS Docket No. 96-85, FCC 96-154, *Notice of Proposed Rulemaking,* 11 FCC Rcd 5937, released April 9, 1996; *USTA Comments* at 1, June 4, 1996.

[10] *USTA Comments* at 4.

[11] *See USTA OVS Comments* at 11 (April 1, 1996); *USTA OVS Reply Comments* at 3 (April 11, 1996), CC Docket No. 96-46.

efforts by cable companies to impose certification and other restrictions on LECs providing OVS would delay, if not kill, LEC interest in providing video programming in this manner. The Commission, however, affirmed its OVS order streamlining the certification process for deployment of OVS.[12] In response to Petitions for Reconsideration of the OVS Order, USTA cited a number of obstacles proposed by cable companies that if adopted would adversely impact LEC consideration of OVS.[13] USTA urged the Commission to reject efforts by cable companies and others to prohibit LECs from bundling video services with other LEC services. In addition, USTA urged the Commission to maintain flexible regulations, not impose cost allocation studies, extend the program access rules to OVS, and prohibit imposition of onerous local regulations.[14] The Act requires that OVS providers benefit from streamlined regulatory treatment. The basis of minimum regulation of OVS is best stated by Congress:

> New Section 653(c) sets forth the reduced regulatory burdens imposed on open video systems. There are several reasons for streamlining regulatory burdens imposed on open video systems. First, the conferees hope that this approach will encourage common carriers to deploy open video systems and introduce vigorous competition in entertainment and information markets. Second, the conferees recognize that common carriers that deploy open systems will be "new entrants" in established markets and

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[12] *See Implementation of Section 302 of the Telecommunications Act of 1996,* CS Docket No. 96-46, FCC 96-334, *Third Report and Order and Second Order on Reconsideration,* released August 8, 1996. The Commission's decision also affirmed its affiliation standard, limitation on cable operator access to OVS, declined to impose additional local programming requirements, and refused to require revisions to cost allocation manuals or separate subsidiaries.

[13] *See Opposition and Comments of United States Telephone Association to Certain Petitions for Reconsideration,* CC Docket No. 96-46 (July 15, 1996).

[14] *Id.* at 3-13.

> deserve lighter regulatory burdens to level the playing field. Third, the development of competition and the operation of market forces mean that government oversight and regulation can and should be reduced.[15]

Congress correctly concluded that the benefits of competition for consumers could best be achieved though minimum regulation which serves as an incentive by LECs to deploy OVS. The marketplace will determine winners and losers.

USTA has stated that onerous cost allocation rules and exogenous price-cap adjustments that penalize investments in broadband facilities will destroy LEC interest in deploying video programming through OVS.[16] Regarding the Commission's efforts to implement the pro-competitive provisions of the Act, economist Alfred Kahn made the following observations regarding the Commission's cost allocation proceeding:

> Local and long distance phone companies, cable TV firms and new ventures will be able to provide the full range of telecommunications services, and consumers will reap the benefits

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15 *See Telecommunications Act of 1996,* Senate Report 104-230, *Conference Agreement* at 178.

16 *See USTA's Cost Allocation Comments* at 2 (May 31, 1996); *USTA's Cost Allocation Reply Comments* at 14 (June 12, 1996), CC Docket No. 96-112. LECs are unlikely to deploy integrated OVS or cable systems under conditions proposed in the Commission's NPRM. In written *ex parte* filings, USTA and member companies have further explained how existing cost allocation regulations are adequate to address Commission concerns regarding cross-subsidization, that consumers benefit from deployment of broadband networks that provide advanced telecommunications services, while allocation of regulated and non-regulated costs pursuant to a 50/50 allocator with an exogenous cost adjustment would effectively eliminate OVS as a viable entry option for LECs to provide video programming. *See USTA Ex parte Comments,* CC Docket Nos. 96-112 and 94-1 (July 17, 1996)(Letter to William Caton, FCC Secretary); *BellSouth Ex parte Comments,* CC Docket No. 96-112 (August 1, 1996)(Letter to FCC Chairman Reed Hundt); *BellSouth Ex parte Comments,* CC Docket No. 96-112 (July 19, 1996)(Letter to William Caton, FCC Secretary); *Pacific Telesis Ex parte Comments,* CC Docket Nos. 96-112, 96-46, and 94-1 (July 19, 1996)(Letter to William Caton, FCC Secretary).

> of competition....
>
> But the FCC seeks to do one thing that would conflict fundamentally with the law's goals. The commission proposes to formulate rules for allocating the economic costs and benefits from the new facilities - largely fiber optic networks - that telephone companies are building to provide both unregulated services like video programming and regulated phone services. In particular, the commission stated in its notice preceding the new regulations: 'We believe that telephone ratepayers are entitled to at least some of the benefit of the economy of scope between telephony and competitive services....'
>
> The commission should call off its cost-allocation rule making, leave the prices of regulated services where they are and let the market work.[17]

Elimination of disincentives for LEC investment in video programming distribution is extremely important given that cable rate-regulation will sunset in 1999.[18] Congress intended that vigorous competition exist in the video marketplace prior to the elimination of cable regulation. Localities and citizens are crying out for competition. In Madison, Wisconsin, a potential competitor to TCI relinquished its license after considering the fact that it would "have to spend upwards of $20 million to install its own cable infrastructure before it could recoup one dollar of revenue from subscribers .... The only cities where meaningful competition is beginning to manifest itself are those where telephone companies are providing competition."[19] But as

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17 *See* Kahn, *Ask Not the Bells for Toll,* Wall St. J., August 8, 1996, at A14; *Declaration of Alfred E. Kahn* at 27, CC Docket No. 112 (July 19, 1996)(The ultimate message to the Commission: call off this cost allocation rulemaking and let the market do the job, as the law clearly instructs it to do).

18 *See Telecommunications Act of 1996,* §301(b)(4), 47 U.S.C. 543(c)(4).

19 *See* Clark, *City doesn't endorse TCI rate hikes but can't prevent them,* July 30, 1996, Wisconsin St. J.

reported, "cable rates keep rising faster than inflation, with the second-highest rate change this decade predicted for 1996."[20]

If LECs are to provide robust competition in the video programming market, barriers to entry must be removed. The public interest will be served when barriers to LEC entry are moved and consumers benefit from significant choice in video programming options.

III. CONSISTENT AGENCY AND INTERAGENCY REGULATORY TREATMENT IS FUNDAMENTAL TO EXPEDITE DEPLOYMENT OF VIDEO PROGRAMMING BY LECS

Inconsistent regulatory treatment can also destroy LEC incentive to deploy video programming. Currently, the Commission is reviewing the allocation of LMDS for voice and video services in light of the 1996 Act requirements.[21] A central issue before the Commission is whether open and unrestricted eligibility should exist for LEC participation in LMDS auctions for licenses awarded in areas served by the incumbent LEC.[22] As the Commission acknowledges, this issues had previously been decided in the affirmative. The Commission concluded that no legal requirement precluded LECs from serving as licensees of LMDS in their

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[20] *See* Farhi, *In Telecommunications, A Tough Act to Follow,* Wash. Post, August 11, 1996 at H1.

[21] *See Rulemaking to Amend parts 1,2, 21, and 25 of the Commission's Rules to redesignate the 27.5-29.5 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services, First Report and Order and Fourth Notice of Proposed Rulemaking* ("*Fourth Notice*"), CC Docket No. 92-297, released July 22, 1996.

[22] *Id.* at ¶105.

local communities.[23] In response to the Commission's *Fourth Notice,* a number of parties noted that it has been the consistent policy of the Commission to favor open eligibility for LEC participation in auctions deploying new technologies.[24] With respect to LMDS, Congress has unequivocally expressed that LMDS was intended to be an option for LECs to provide video services.[25] Athough the oucome of the eligibility issue remains in doubt, the spector of inconsistent regulatory treament of LECs in the LMDS proceeeding can only create consternation for LECs, and delay LMDS deployment. Commission Chairman Reed Hundt has stated "The goal of the Telecommunications Act is to let anyone enter any communications business -- to let any communications business compete in any market against any other."[26] In addition, Chairman Hundt expressed the view that successful implementation of the 1996 Act required the Commission to answer the question "... are we going to succeed in writing rules that support competitive markets as opposed to favoring individual competitors?"[27] As USTA and

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[23] *Id.* at ¶108, *citing Rulemaking to Amend Parts 1,2, 21, and 25 of the Commission's Rules to redesignate the 27.5-29.5 GHz Frequency Band, to Establish Rules and Policies for Local Multipoint Distribution Service and for Fixed Satellite Services, Third Notice of Proposed Rulemaking and Supplemental Tentative Decision,* CC Docket No. 92-297, FCC 95-287 at ¶104, released July 28, 1995.

[24] *See Comments of USTA* at 9; *Comments of Ameritech* at 4; *Joint Comments of Bell Atlantic and SBC Communications, Inc.* at 3-6, CC Docket No. 92-297 (August 12, 1996).

[25] *See Telecommunications Act of 1996,* Senate Report 104-230 at ¶170 (February 1, 1996); *Comments of USTA* at 6 and *Comments of BellSouth* at 3, CC Docket No. 92-297 (August 12, 1996).

[26] *See* R. Hundt, *Implementing the Telecommunications Law of 1996: The Real Work Begins,* Newsweek Telecommunications Forum, Washington, D.C. (February 21, 1996).

[27] *Id.*

others have expressed, the Commission has consistently held that open eligibility promotes the selection of entities capable of swiftly deploying new technologies for the benefit of consumers.[28]

Interagency decisions which are inconsistent can have the same negative impacts as the lack of predictablity in Commission decisions. Consistent with the Act,[29] the Commission determined in the OVS Order that OVS providers would be treated like cable service providers for purposes of applying the cable compulsory license.[30] The United States Copyright Office, however, has asked for comments in a pending proceeding on whether OVS is a cable system as defined by the Copyright Act.[31] USTA urged the Copyright Office to recognize the plain meaning of the Act, and that exclusion of OVS from the cable compulsory license[32] would subject providers to increased transaction costs and inefficiencies, which creates a competitive disadvantage for OVS relative to established cable providers.[33]

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[28] *See Comments of USTA* at 9; *Comments of Ameritech* at 4; *Joint Comments of Bell Atlantic and SBC Communications, Inc.* at 3-6, CC Docket No. 92-297.

[29] *See Telecommunications Act of 1996,* Section 653(c)(4), 47 U.S.C. 573(c)(4).

[30] *See Implementation of Section 302 of the Telecommunications Act of 1996* (Open Video Systems), Second Report and Order, CS Docket No. 96-46, FCC 96-249 at ¶170.

[31] *See* Copyright Office Docket No. 96-2, *Eligibility for the Cable Compulsory License, Notice of Inquiry,* 61 Fed. Reg. 20197 (May 6, 1996).

[32] 17 U.S.C. §111.

[33] *See USTA Comments* at 6 (July 5, 1996).

IV. REGULATORY REVIEW OF VIDEO PROGRAMMING AND CABLE SYSTEM DISTRIBUTION MERGERS MUST ENSURE LEC ACCESS TO PROGRAMMING ON EQUAL TERMS

In earlier reports, the Commission has recognized that cable companies have market power because of highly concentrated local ownership and control of programming distribution through affiliated companies.[34] As the FCC stated in its 1995 Cable Report "markets for the distribution of video programming are not yet competitive."[35] Enormous competitive hurdles continue to be faced by competitors of cable providers in the video programming market as ownership of cable systems is concentrated in local markets ("horizontal concentration") and programming ownership and distribution is concentrated in the hands of affiliates of cable system operators ("vertitcal intergration"). Based upon this market power,[36] the Commission has affirmed its decision to limit access of cable systems and programmers affiliated with cable systems from access to OVS systems.[37]

USTA stressed its concerns in the Commission's review of the TimeWarner/Turner

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[34] *See Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming, Second Report and Order,* CS Docket No. 95-61, 11 FCC Rcd 2060, 2063 at ¶5 (1995); *First Report,* CS Docket No. 94-48, 9 FCC Rcd 7442, 7449 ¶13 (1994).

[35] *Id.* 11 FCC Rcd at 2150, ¶194.

[36] The Federal Trade Commission and the Department of Justice Anti-Trust Division determined that cable operators posses substantial market power, and as a result cable companies have maintained prices above the level that would exist in a competitive market. *See OVS Third Report and Order and Second Order on Reconsideration,* CS Docket No. 96-46, FCC 96-334 at ¶49, released August 8, 1996.

[37] *Id.* at ¶¶ 48-53.

Broadcasting merger,[38] regarding the importance of horizontal concentration and vertical integration barriers to LEC entry into the video programming market. As USTA members begin exploring options to compete with the cable industry as multichannel video programming distributors ("MVPDs"), "the availability of programming at prices and terms that are comparable to those received by the largest cable multiple system operators ("MSO") is critical to their success."[39] With programming costs exceeding 40% of an MVPD's costs to offer video programming, it becomes vitally important to LECs to ensure that their access to programming, and the terms and conditions of purchasing such programming[40] is equal to that received by MSOs through their affiliated programming providers. USTA believes that discriminatory pricing arrangements, like those reportedly benefiting TCI[41] in the Time Warner/Turner merger violate the program access provisions of the Commission's regulations,[42] and adversely impact

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38 *See Turner Broadcasting System, Inc., Transferor, and Time Warner Inc., Transferee, For Transfer of Control of License of WTBS (TV), Atlanta Georgia,* FCC Docket No. BTCCT-951020KF, *USTA Comments and Request for Imposition of Conditions* (December 1, 1995);*USTA Reply Comments* (January 11, 1996).

39 *USTA Comments* at 2.

40 *Id.*

41 Sloan, *The Greed Factor Hits a New Level with the Turner Broadcasting-Time Warner,* Wash. Post, October 3, 1995, at D3. According to the article, TCI would receive 20 years of programming services from Time Warner/Turner at current rates with no price increases -- a deal estimated to be worth $1.4 billion. Yet, a program purchasing arrangement between Americast, a LEC programming consortium comprised of Ameritech, BellSouth, GTE and SBC, did not receive the same benfits as TCI. Clearly, under such conditions, LECs would enter the video programming market at a competitive disadvantage. *See also*, Gruley and Shapiro, *Time, FTC Staff Agree on Turner Deal,* Wall St.J., July 18, 1996 (TCI 15% discount on Turner programming over 20 years is canceled).

42 *USTA Reply Comments* at 3, FCC Docket No. BTCCT-951020KF; 47 U.S.C. §548; 47 C.F.R. 76.1002(b)(setting forth requirements for satellite cable programming vendors

the growth of competition among MVPDs intended by the 1996 Act. USTA has consistently argued for parity of program access. In response to Petitions for Reconsideration of the OVS Order, USTA argued against efforts by cable companies and others to reverse the Commission's initial decision to apply the program access requirements to OVS providers. USTA commented that "parity of access is an essential pre-condition for LECs to provide meaningful competition to incumbent cable operators, due to the concentration of control over vast portions ... of programming among a handful of vertically integrated cable operators."[43] The Commission affirmed its earlier determination applying the program access regulations to OVS.[44]

A number of parties have ignored these facts. HBO states that "competition in the market for delivery of video programming continues to be robust and that there is no justification for continued government involvement, especially with respect to access to programming by MVPDs."[45] NCTA submits that cable operators face accelerated competition that is slowing subscriber growth.[46] Time Warner predicts that the passage of the 1996 Act will rapidly accelerate competition in the video programming market, especially from telephone companies

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and affiliates to offer non-discriminatory prices, terms, and conditions).

43 *See USTA's Opposition and Comments of United States Telephone Association to Certain Petitions for Reconsideration* at 7, CS Docket 96-46, July 15, 1996.

44 *See Third Report and Order and Second Order on Reconsideration* at 73, CS Docket No. 96-46, released August 8, 1996.

45 *See Comments of Home Box Office* at 6-7 (July 19, 1996).

46 *See Comments of the National Cable Television Association, Inc.* at 1-4 (July 19, 1996).

providing OVS.[47]

To suggest that the video programming market is competitive is self serving. As DIRECTV expressed, the Commission, citing the Department of Justice, agreed that the video programming market is "a series of local monopolies controlled by cable operators."[48] USTA agrees with BellSouth's Comments that "removal of legal barriers to entry does not ensure that competitive entry into video programming markets will be any more successful in the future than in the past."[49]

V. CONCLUSION

The video programming distribution market is not competitive. The market power of incumbent cable systems create overwhelming hurdles to LEC entry into video programming distribution. The 1996 Act creates opportunities and hope for LECs to enter the video programming market. Competitive entry, however, does not necessarily result from opportunities. Legal and regulatory impediments to LEC entry into video programming distribution remain unresolved. Access to programming on terms and conditions equal to incumbent cable providers is critical to establishing the foothold required by LECs to compete in the video distribution marketplace. Thus, consumer choice, competitive pricing, and improved quality of service remains unfulfilled. LECs welcome the challenge of competing on a level

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47 *See Comments of Time Warner Cable* at 3 (July 19, 1996).

48 *See Comments of DIRECTV, Inc.* at 2 (July 19, 1996).

49 *See BellSouth Comments* at 3 (July 19, 1996).

playing field. USTA hopes to report next year on significant improvements in the video distribution market.

Respectfully submitted,

UNITED STATES TELEPHONE ASSOCIATION

By: Keith Townsend

Mary McDermott
Linda Kent
Charles D. Cosson
Keith Townsend

1401 H Street, NW
Suite 600
Washington, D.C. 20005
(202) 326-7247

August 19, 1996

CERTIFICATE OF SERVICE

I, Gina Bechberger, do certify that on August 19, 1996 copies of the Replies of the United States Telephone Association were either hand-delivered, or deposited in the U.S. Mail, first-class, postage prepaid to the persons on the attached service list.

Gina Bechberger

Gina Bechberger

Daniel L. Brenner
Neal M. Goldberg
Loretta P. Polk
National Cable Television Association, Inc.
1724 Massachusetts Avenue, NW
Washington, DC 20036

Arthur H. Harding
Craig A. Gilley
Fleischman and Walsh, LLP
1400 16th Street, NW
Sixth Floor
Washington, DC 20036

James U. Troup
Arter & Hadden
1801 K Street, NW
Suite 400K
Washington, DC 20036

Henry M. Rivera
Jay S. Newman
M. Tamber Christian
Ginsburg, Feldmand & Bress, Chtd.
1250 Connecticut Avenue, NW - Suite 800
Washington, DC 20036

Henry Goldberg
W. Kenneth Ferree
Goldberg, Godles, Wiener & Wright
1229 19th Street, NW
Washington, DC 20036

Quincy Rodgers
Christine G. Crafton
Faye Morrison
General Instrument Corp.
1133 21st Street, NW - Suite 405
Washington, DC 20036

Michael R. Gardner
Charles R. Milkis
Attorneys at Law
1150 Connecticut Avenue, NW - Suite 710
Washington, DC 20036

William R. Richardson, Jr.
Wilmer, Cutler & Pickering
2445 M Street, NW
Washington, DC 20037

Paul J. Sinderbrand
Wilkinson, Barker, Knauer & Quinn
1735 New York Avenue, NW
Washington, DC 20006

Andrew R. Paul
Satellite Broadcasting and Communications Assn.
225 Reinekers Lane
Suite 600
Alexandria, VA 22314

Benjamin J. Griffin
Kathleen A. Kirby
Reed Smith Shaw & McClay
1301 K Street, NW
Suite 1100 - East Tower
Washington, DC 20005

Steven T. Berman
Jack Richards
John Reardon
Keller and Heckman, LLP
1001 G Street, NW - Suite 500 West
Washington, DC 20001

Gary M. Epstein
James H. Barker
Latham & Watkins
1001 Pennsylvania Avenue, NW - Suite 1300
Washington, DC 20004

Robert L. Begleiter
Lloyd Constantine
Constantine & Partners, PC
909 Third Avenue - 10th Floor
New York, NY 10022

Eliot Spitzer
Yang Chen
Constantine & Partners, PC
909 Third Avenue - 10th Floor
New York, NY 10022

Edward D. Young, III
Michael E. Glover
Leslie A. Vial
Bell Atlantic
1320 North Courthouse Road - Eighth Floor
Arlington, VA 22201

Durward D. Dupre
Mary W. Marks
Southwestern Bell Telco.
One Bell Center - Room 3536
St. Louis, MO 63101

R. Douglas Lackey
Michael A. Tanner
BellSouth
675 West Peachtree Street, NE - Suite 4300
Atlanta, GA 30375

Renee M. Martin
Ameritech New Media, Inc.
300 S. Riverside Plaza
Suite 1800 North
Chicago, IL 60606

Robert M. Lynch
David F. Brown
SBC Communications, Inc.
175 East Houston - Room 1254
San Antonio, TX 78205

Arthur D. Harding
Matthew D. Emmer
Scott H. Kessler
Fleischman and Walsh, LLP
1400 16th Street, NW - Sixth Floor
Washington, DC 20036

ITS
2100 M Street, NW
Suite 140
Washington, DC 20036